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**WILL DR BEN BERNANKE REDUCE INTEREST RATES ?
HERE ARE SOME OF THE FACTORS
THAT WILL INFLUENCE HIS DECISION**

Just about every day, now, US television talk shows bring up the question as to whether or not the US Federal Reserve will continue to reduce interest rates.

Speculation is rife about the likely outcome of the next 2-day, Open Market Committee Meeting of The Fed, scheduled for October 30-31, with the consensus, appearing to favour a further interest-rate cut of at least 25 basis points.

Various Wall Street gurus have a wide variety of gobbledygook that they employ in order to justify their pet theories about the future direction of interest rates in The Land of The Free and The Home of The Brave.

Some gurus claim that, in the past, The Fed has, always, followed a pattern and that, once the pattern has been in force for an extended period of time – presumably, 3 months or 4 months – there is unlikely to be any variance from that pattern.

Some gurus claim that The Fed will consider the financial requirements of the US economy, only, and, then, act accordingly.

And, of course, there are those gurus who claim that inflation is the thing – and containing inflation is everything.

And so the gurus' pet theories continue to proliferate, including, but not limited to, chart-followers, the singing of religious incantations to the pantheistic gods of this or that, and one must not forget the groundhog theory of interest rates: If the groundhog awakens early in the spring, then, interest rates are bound to rise, quickly on the wing.

The truth of the matter with regard to future movements of interest rates in the US, the Antipodes, the United Kingdom, the European Union and those countries of Europe, which are not part of the European Union, is that all of these regions of the industrialised West follow the perceived basic requirements of the day; and, that determinations in respect of interest-rate changes are predicated not by one factor, but by a host of factors.

The nature of financial markets, from New York City, to Tokyo, Japan, to Wellington, New Zealand, is that they are all influenced by what is happening, not just domestically, but internationally.

In short, global developments determine, to a greater or lesser degree, the movements of the international financial service industry.

All of the developed economies of the Western, industrialised world are heavily influenced by what happens, globally.

The world has shrunk to such a degree over the past 3 decades or so, due in large part to the rapid growth of technological advances, especially in the field of communications, that a problem at one corner of the world has the ability to influence a financial decision in the furthest corner of the globe to where the problem originated.

When the People's Republic of China starts to buy up large quantities of a strategic commodity within a short space of time, the price increase of that strategic commodity, directly and indirectly, has the ability to cascade right around the world.

One has witnessed this phenomenon over the past few years with regard to the price of crude oil, iron, copper, gold, etc.

Whenever there is turbulence in the financial markets, as happened only one month ago, it may well have an important bearing on any and all decisions of the regulatory authorities, responsible for keeping an economy on what is considered an even keel.

The object of every well-ordered economy of the world is to try to keep inflation in check, as low as possible, in most cases, but, also, keeping inflation as stable as possible.

In open economies, such as those of the US, the European Union, the United Kingdom, Japan, Australia, New Zealand, etc, as **TARGET** () has just explained, forces, internationally, have the ability to cause inflation to fluctuate, sometimes violently in the short term, and these fluctuations have the ability, also, to create volatility in an economy.

Rapid increases in the price of crude oil on international commodity exchanges have resulted in increases in the rate of inflation over the past few years, as every businessman and industrialist is well aware.

Naturally, interest-rate decisions, determined by the appropriate, regulatory authorities, take note of such phenomenon; and, their decisions may well be influenced by such occurrences.

Therefore, adjustments in interest rates must take note of a number of global influences and the aim of interdependent government agencies, such as The Fed, The Bank of England, The European Central Bank, The Reserve Bank of Australia, and The Bank of Tokyo, inter alia, must ensure that international influences do not create prolonged and significant deviations in inflation from target levels.

However, a singular determination by a regulatory authority of a country has to be weighed on domestic scales in order to arrive at the appropriate monetary policy of the day.

Interest-rate adjustments have to ensure, at the same time, that international influences do not further the cause of prolonged and significant deviations in ascribed inflation targets.

The problems, facing many regulatory authorities, are their abilities to respond to international developments as they become manifest in a timely fashion.

Import Prices and Foreign-Exchange Translation

The prices of imported goods and services in a country can impact on a country’s economy and, more often than not, they do.

Directly and indirectly, it is estimated that about 30 percent of the value of goods and services, sold by countries, domestically and internationally, are influenced, materially, by the price of imports.

The bulk of the import bill is in finished and semi-finished, manufactured goods.

The import bill for fuels is known to be a contributing factor, along with the import costs of other basic materials, which accounts for a further 10 percent in the value of exported goods and services.

There is one other factor that cannot be overlooked: The prices of imported manufactured goods, also, reflect the raw materials’ costs and the energy costs, expended in their manufacture.

This has the effect of creating additional pressure on the prices of commodities, sold on such venues as The New York Mercantile Exchange.

Strong demand growth, domestically or internationally, causes profit margins to widen; and, this phenomenon, in turn, may create upward pressure on costs.

This is especially so when a country’s industries are operating close to full capacity.

The converse of the above is, also, true of course: Weak demand growth dampens influences on costs and limits price rises, thus crimping profit margins.

Increases and falls in interest rates, therefore, influences demand conditions within a country and central banks have used interest-rate fluctuations for many a year in order to make adjustments in economies and, by so doing, balance an economy.

Economic developments, internationally, affect the demand criteria, directly and indirectly, within an economy.

The direct influences include, of course, the changes in the demand for the sales of a country's goods and services.

All countries of the world, today, depend to a great extent on export sales; and, they have to remain competitive in the cutthroat marketplaces in order to be successful in their endeavours.

As may be concluded from the above, international events play a more and more important role in interest-rate determinations by central banks of nearly every country of the Western World.

International events, also, have an important bearing on inflation in the Western World as has, already, been pointed out.

As **TARGET** has stated on many occasions, if the world's tailor shop – the People's Republic of China – were to stop selling its shirts, pants, jackets, etc, to the US, it would result in galloping inflation in the US within a very short period of time.

The plethora of Chinese-made garments and other goods, entering the US marketplace, today, dampens inflationary pressures in the country.

If the People's Republic of China were to stop selling its garments to the US, consumers in the world's most-important single economy would be forced to purchase, either domestically produced, similar garments at much higher prices, or seek replacement garments from some other country, also, at higher prices than are, presently, available from the People's Republic of China.

In either event, there would be an upward pressure on inflation in The Land of The Free and The Home of The Brave.

Inflation in the US, Japan, the United Kingdom, the European Union and the Antipodes is determined, today, by, among other things, the ability of the world to feed various economies with goods and services, those goods and services, being required from time to time.

The cost to consumers of imports is regulated:

1. By demand;
2. The pricing climate of the day;
3. The translation value of a country's currency, vis-à-vis the currency of that country's major trading partners;
4. The domestic demand for imported goods and services; and/or;
5. The expectations of the population of the country to where the goods and services are sold.

The resultant could rightly be termed as the inflationary effect.

The translation of one currency into the currency of another country, therefore, can have a very telling effect on inflation.

The US Government has, for some time, been trying to pressure the Government of the People's Republic of China to allow the renminbi to be revalued upward because an undervalued renminbi – as alleged by many economists and politicians of the US – causes added inflationary pressure on its trading partners, especially in respect of the economy of the US.

Global shocks on foreign-exchange markets may be stabilised by a country's monetary policy which takes account of any and all wide swings in the translation values of a major, trading partner's currency.

Monetary policy, however, does not control exchange rates although it can have an important influence.

If a country's regulatory authority determines, therefore, to tighten its monetary policy, relative to a trading partner(s), or it is thought, generally, that such a tightening is imminent, this will tend to boost exchange rates in the short term.

This, in turn, will dampen import prices and, indirectly, affect international pressures in respect of inflation.

Monetary policies, also, affect the spending habits of consumers.

Consumer spending accounts for upwards of 50 percent of domestic spending.

Thus, a tightening of a monetary policy may well have a significant impact on the growth of consumption, and it follows, it is likely to affect domestic demand.

The US Federal Reserve, therefore, in order to be true to its mandate, must consider all of the above factors; and, all of the above factors are capable of rapid changes between now and the next Open Market Committee Meeting of The Fed.

Large and persistent changes and/or persistent deviations in inflation must be avoided, of course, but this is often difficult to control or predict due to the rapid changes in the global economy.

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